

# AN ANALYSIS OF UGANDA'S TAX SYSTEM: IS IT FAIR?

2019

## Background

### Goals and objectives

- Examine the Uganda's current tax system based on the indicators listed and assess the fairness of Uganda's tax system
- Identify main bottlenecks in the tax systems of focus countries
- Provide a strong evidence-based support for country-level advocacy work
- Generate comparative information for assessing selected countries over time  
Contribute to the global-level advocacy on taxation through evidence-based tool showcasing relative fairness of selected tax systems

Over the last three decades, Uganda's main tax objective has been to mobilize domestic revenue as a way of providing essential public services and reducing foreign aid dependence. However the challenge facing Uganda is how to equitably and sustainably mobilise resources in order to provide social services, infrastructure and for reinvestment. Currently, there are efforts by government to increase domestic revenue through taxation.

This policy brief is a product of a study titled **"Fair Tax Monitor: Uganda."** While conducting the study, reference was made to

a Common Research Framework (CRF) which is divided into six thematic categories: Progressive Tax System; Sufficient Revenues; Well Governed Tax Exemptions; Effective Tax Administration; Pro-Poor Government Spending; and Accountable Public Finances. These categories are meant to cover key issues that tax systems in developing countries face today while reflecting a fair tax system. Below is a summary of the key findings and recommendations of the study.

## Overview of Uganda's Tax System

Uganda's Tax administration is governed by a number of laws such as: the Constitution of the Republic of Uganda, 1995; Income Tax Act, Value Added Tax Act, Tax Procedures Code Act, 2014; The East African Excise Management Act, Excise Management Act; Uganda Revenue Authority (URA) Act and Local Government Act; among others. In addition, there are a range of institutions at national and local/district levels, which include: Ministry of Finance, Planning and Economic Development (MoFPED), URA, Parliament of the Republic of Uganda, Ministry of Local Government (MoLG), Ministry of Trade and Industry, and Local Governments (LGs), among others.

Tax laws are annually amended mainly to increase tax revenue. The major tax amendments evolve around VAT, Income tax, Excise duty, Customs and Non-tax

revenues. Despite these amendments, the country has continued to register low revenue collections which cannot sufficiently finance the budget.

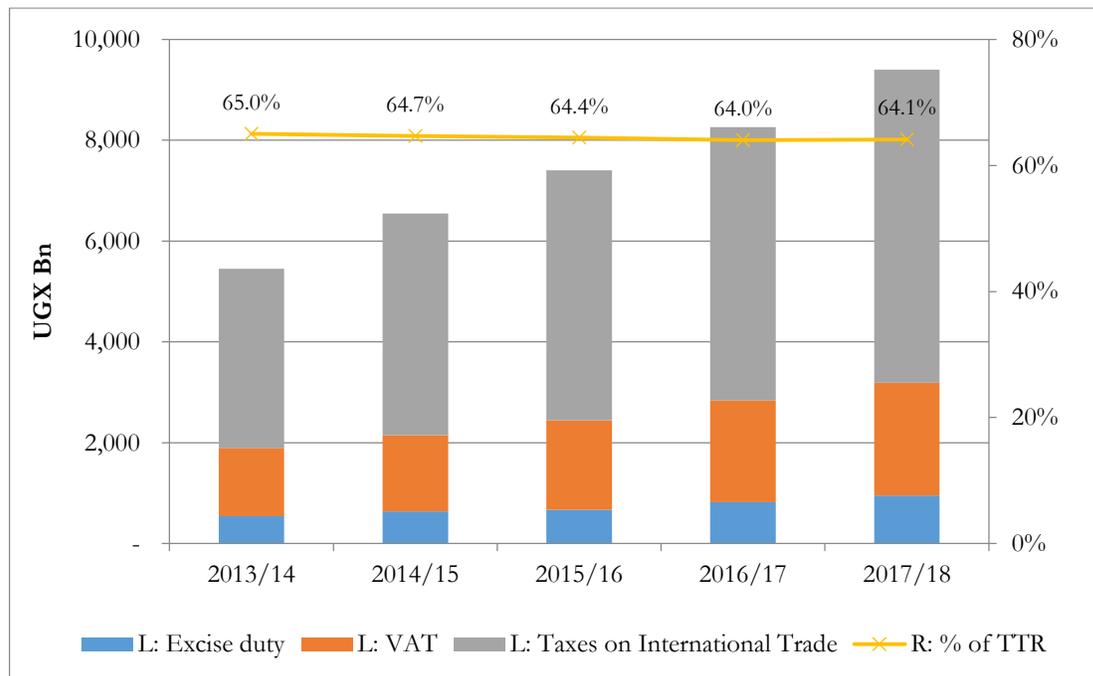
Uganda has seen a significant increase in Total Tax Revenue (TTR) which has increased during the last 5 years from UGX 8.38 Tn (US\$ 3.3 Bn) in 2013/14 to UGX 14.66 Tn (US\$ 4.01 Bn) in 2017/18. However, Uganda performs poorly on actual collection of tax compared with the potential levels that could be collected. While the URA year-on-year revenue collections growth rate averaged 15% during the last five years (2013/14 – 2018/19), the collections were below the target for three FYs 2013/14, 2016/17 & 2017/18. For instance, according to the annual URA Revenue Performance Reports, Corporate Income Tax (CIT) and Value Added Tax (VAT) collections posted on average a deficit of UGX 68 Bn (US\$ 24 Mn) and UGX 122 Bn (US\$ 29 Mn) between 2013/14 and 2017/18 respectively. A study by the International Monetary Fund (IMF) in 2014 found that VAT compliance levels in Uganda were below that of countries at a similar level of development. Consequently, Uganda has not raised its tax-to-GDP ratio to the level of other EAC countries. While Uganda's revenue-to-GDP ratio stood at 13.8% in 2015/16, Kenya's was at 15.9% and Rwanda's at 14.9%.

## Distribution of the Tax Burden and Progressivity

### Tax Burden

Uganda's tax revenue is largely from indirect taxes, including: excise duty, Value Added Tax (VAT) and taxes on international trade. Indirect taxes make up the majority of Uganda's Total Tax Revenue (TTR). This is so despite the fact that its share has marginally reduced from 65% in 2013/14 to 64% in 2017/18.

Figure 1: Trends in Indirect Taxes



Source: Author's calculations based on URA Statistics<sup>1</sup>

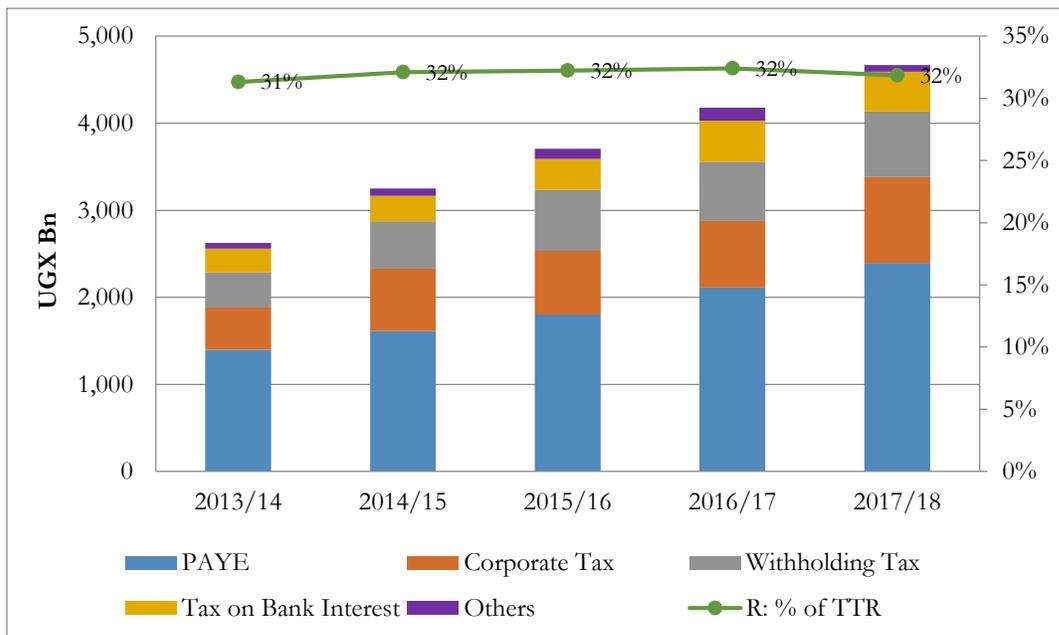
Based on the value of goods, services and assets, rather than people's ability to pay, indirect taxes are regressive<sup>2</sup>. Indirect taxes are more burdensome on poor people (even if some goods and services VAT exempted). In their study, Jon Jellema et al, 2016<sup>3</sup> noted that VAT and Excise taxes were widespread – over 95% of households pay at least one of the indirect taxes and the burden they create is approximately neutral with respect to consumption expenditure. Indirect taxation also affects women more because they spend a higher proportion of their income on consumer goods for their families. Women tend to spend more of the income on goods that contribute to the social reproduction of labour, including healthcare, education, food, child care and the elderly.

Uganda's direct domestic taxes include: Personal Income Tax (especially through PAYE), corporate tax, presumptive tax, rental tax, withholding tax, tax on bank interest, casino and lottery tax and tax on agricultural products. Direct taxes are viewed as progressive, as they affect those with greater earnings more as a proportion of income than those with less.<sup>4</sup> The share of direct domestic taxes in TTR has oscillated around 32% over the last financial years

## Progressivity

While the **Direct Taxes have often been thought of as more progressive, their contribution to the TTR has oscillated around 32% over the last financial years<sup>1</sup>**. The tax burden is always on an individual or entity and can't be shifted by the taxpayer to someone else. It is worth noting that Personal Income Taxes (administered as PAYE) contributes the biggest percentage of the direct taxes. The PAYE mode of assessment applies to employees and business owners regardless of the sector.

Figure 2: Trends in Direct Taxes



Source: Author's calculations based on URA Statistics

In nominal amounts **PIT collections increased from UGX 1,451 Bn (US\$ 572 Mn) in 2013/14 to UGX 2,451 Bn (US\$ 670 Mn) in 2017/18**, and according to the annual URA Revenue Performance Reports<sup>5</sup>, PIT collections posted on average a surplus of UGX 33 Bn (US\$ 10 Mn) between 2013/14 and 2017/18. Corporate Income Taxes (CIT) have registered a tremendous increase from UGX 487Bn (US\$ 192 Mn) in 2013/14 to UGX 986 Bn (US\$ 270 Mn) in 2017/18. However, according to the annual URA Revenue Performance Reports<sup>6</sup>, **CIT collections posted on average a deficit of UGX 68 Bn (US\$ 24 Mn) between 2013/14 and 2017/18**. As a share of the total tax revenue, the collections stagnated at an average of 6.4% during the same period. **The low performance is blamed on several issues. First, the effective rate of tax is lower than what is stated in the law**

<sup>1</sup> This includes only direct domestic taxes

(30%). Also, non-transparent provision of tax incentives and exemptions, exploitation of Double Taxation Treaties by Multinational Corporations (MNCs), and inadequate implementation of punitive sanctions on tax dodging and avoidance leads to reduced collection'. Due to exemptions and avoidance by multinationals, small women-owned businesses are more heavily taxed, while larger male-owned enterprises are taxed less heavily.

The percentage of the active population (those engaged in productive work) that are registered for taxes is still very low at only 6.8%, though the share has been increasing during the last five (FYs 2012/13 -2016/17). Despite some increment over the past five years, the percentage of established and operational business entities registered with URA for taxes is still very low at only 7.1%. This means the tax burden is concentrated within a few people and businesses. Uganda has one of the lowest taxpayer to labour force ratio for income tax of 0.09%, compared to Kenya at 37.30% and Tanzania at 5.88%, whereas that of VAT is 0.10% compared to that of Kenya at 2.31%

## Effectiveness of Tax administration

Uganda has seen a significant increase in Total Tax Revenue (TTR<sup>8</sup>) during the last 5 years (2013/14 – 2017/18). Gross revenue increased by 75% from UGX 8.38 Tn (US\$ 3.3 Bn) in 2013/14 to UGX 14.66 Tn (US\$ 4.01 Bn) in 2017/18. Despite the fact that there has been tremendous increase in revenue collections, Uganda Revenue Authority has often failed to meet its annual targets. Failure to meet annual revenue collection targets means Uganda can't raise its tax to GDP ratio of 16% by 2019/20 set in the National Development Plan (NDP) II<sup>9</sup>, and close the gap with other EAC countries. There are also concerns that while setting tax revenue targets by MoFPED, more focus is put on increasing revenue collections instead of addressing inefficiencies in tax administration.

The tax laws, policies and institutions currently focus on establishing a more "efficient" collection of taxes, with less efforts being directed at the principles of equity and progressivity. The URA has become more aggressive in collecting tax from noncompliant taxpayers due to tax shortfalls from its small tax base. There are continuous yearly increments on duties and taxes on basic goods and services such as fuel, salt, sugar, cement and others, placing a heavier tax burden on low income earners who form the biggest proportion of these commodity consumers. Some research has unearthed revenue potentials that exist among High Net-worth Individuals (HNWIs). However, no specific regime has been constitutionalized to guide taxation of their wealth. Consequently, most HNWIs are not paying their fair portion of taxes.

In terms of the cost collection, it is worth noting that between 2013/14 and 2017/18, the cost of tax collection averaged 2.4% - i.e. for every UGX 3,659 (US\$ 1) that was allocated

to URA, UGX 39.5 Bn (US\$ 10.8 Mn) was collected during FY 2017/18. This fits within the sub-Saharan average of 2–3%, but is much higher than the OECD average of 1%.

Between 2013/14 and 2017/18, the Budget allocation to URA increased on a yearly average by 13%. A big chunk of the URA budget is current in nature, with current expenditures constituting over 83% of the total authority budget. As a share of GDP, the URA budget oscillated between 0.29% to 0.36% between 2013/14 and 2017/18.

In FY 2017/18, the URA employed 2,408 staff, of which 1,965 were operational staff. The URA staff-to-Taxpayer ratio has been increasing over the last five years from 1:148 in 2012/13 to 1:672 in 2017/18. This is mainly due to the expansion of the taxpayer register and minimal recruitment of staff. The URA staff-to-Taxpayer ratio is comparable with other EAC countries; during 2016/17, Kenya stood at 1:861; Rwanda stood at 1:233; Tanzania stood at 1:814 and Burundi stood at 1:993. Nevertheless, the number of URA staff does not tally with the nature and heavy workload at URA main service centres. A large taxpayer-staff ratio has implications on service delivery and constrains revenue administration.

At the local government, the Department of Finance - which is responsible for local revenue - in most district local governments does not have professional revenue officers. Those in post are professional accountants and just assigned the duties of this function but have no technical knowledge on how to advise the LG to generate local revenues. The challenges of low staffing are largely due to government's ban on staff recruitment and the high levels of qualifications required by the government for the position of revenue officers, despite a very low remuneration. Additional challenges include: poor facilitation of officials involved in local revenue mobilization; lack of basic transport means to effectively reach the taxpayers; lack of the requisite capacity; and skills in taxation, especially assessment of taxpayers.<sup>2</sup>

## Governance of Tax Exemptions

A number of legal and policy frameworks give discretionary powers to individuals to award tax exemptions. For example, Section 77(1)-(2) of the Public Finance Management Act (PFMA), 2015 accords the Minister to award tax exemptions and thereafter report and justify the award to parliament. This limits parliament exercising its oversight role before exemptions and incentives are awarded. Retrospective oversights such as these weaken parliamentary supervision and breeds impunity in executive public mandates.

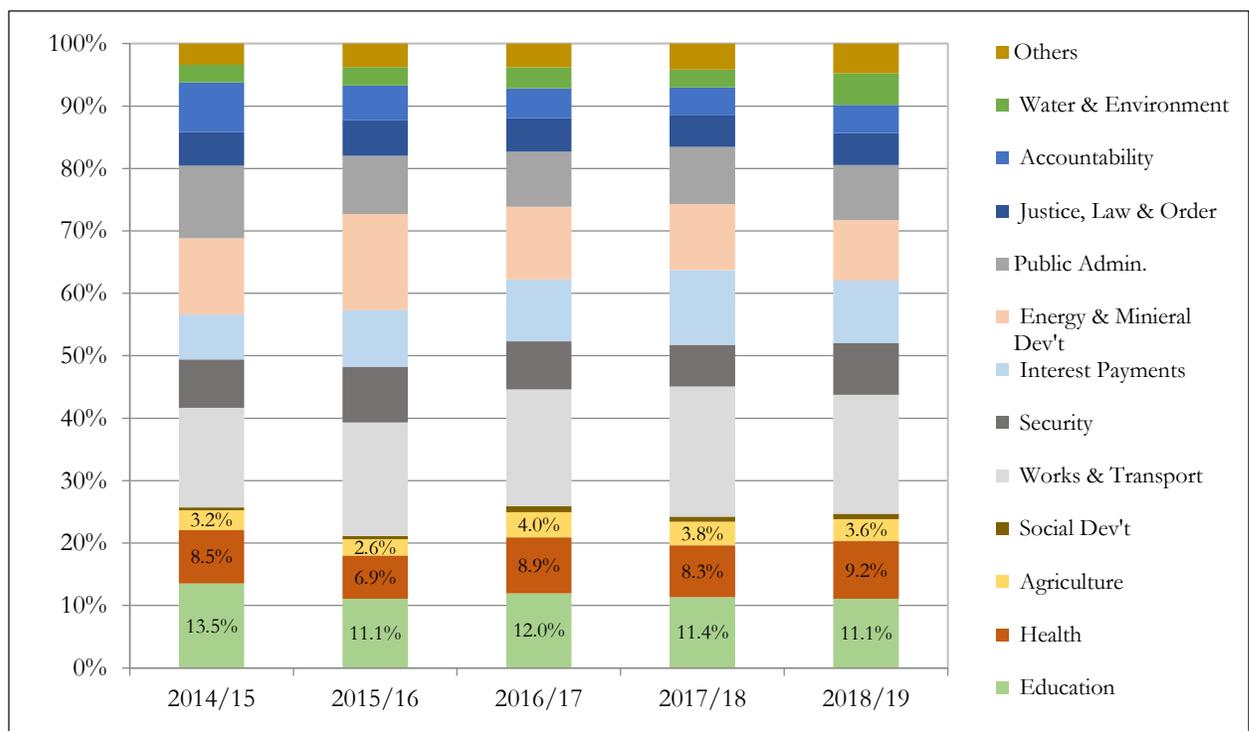
Since there is no clear policy on tax incentives and exemptions, Uganda is losing a lot of revenue. According to the URA, Uganda's lost revenue from tax incentives and exemptions alone amounted to UGX 8,440 Bn (US\$ 3,073 Mn) from 2010/11 to 2016/17, an equivalent of 16% of the total tax revenue. The amount of revenue lost in 2016/17 was

<sup>2</sup> Taxation in Uganda, SEATINI Uganda & Oxfam (2017)

nearly equal to the agriculture budget (which was UGX 823.4 Bn US\$ 234 Mn- in 2016/17). The main beneficiaries of tax exemptions are mainly Multinational Corporations (MNCs), with no similar incentives for smaller businesses, which is unfair. Unfortunately, information about beneficiaries of tax exemptions is not publicly available and the procedure for granting them is not transparent.

## Government Spending

Figure 3: Trends in Government Sectoral Budget Allocations (Share)



Source: Author's computations based on MoFPED reports

Despite the increase in government revenue from UGX 10.6 Tn (US\$3.76 Bn) in 2014/15 to UGX 27.4 Tn (US\$7.50 Bn) in 2018/19 of which 65% were tax revenues, spending still outstrips revenue collection, a situation that escalates the annual budget deficit. The budget deficit increased from UGX 3.37 Tn (US\$ 1.2 Bn) in 2014/15 to UGX 7.4 Tn (US\$2.0 Bn) in 2018/19, which is nearly half of total tax revenue for the year. To finance the deficit, the government has continued borrowing, resulting into an increase in the public debt. Uganda's public debt stood at US\$ 10.53 billion (equivalent to 38.1% of GDP) as at March 2018.

Uganda's total budget allocations increased from UGX 14.97 Tn (US\$ 5.3 Bn) in 2014/15 to UGX 25.1 Tn (US\$ 6.9 Bn) in 2018/19. The government's total budgetary allocation in

nominal terms to the social sectors (education, health, social development) and agriculture increased over the last five years from UGX 3.85 Tn (US\$ 1.4 Mn), in 2014/15 to UGX 6.20 Tn (US\$ 1.7 Mn) in 2018/19.

The government's total budgetary allocation in nominal terms to the social sectors (education, health, social development) and agriculture increased over the last five years from UGX 3.85 Tn (US\$ 1.4 Bn), in 2014/15 to UGX 6.20 Tn (US\$ 1.7 Bn) in 2018/19. However, the high spending on interest payments, public administration and the military sector impacts negatively on government spending in social sectors and agriculture. The money allocated to social sectors and agriculture has remained stagnant at a quarter of the national Budget. Consequently, Uganda is also unable to meet her international and regional commitments which include allocating at least 15%, 10% and 15% of the annual Budget to health, agriculture and education sectors, respectively. All government MDAs and LGs are supposed to integrate gender and equity in their development / investment plans and Budget Framework papers. The Equal Opportunities Commission (EOC) noted that there was improvement in the way the various votes appreciate gender and equity issues. However, there was a decline in compliance to gender and equity requirements of the Ministerial Policy Statements (MPSs) from 53% in the FY 2016/2017 to 48% in FY 2017/2018.

## Transparency and Accountability

Information on the tax system (tax rates and tax collections) is publicly available. Such information is published by both MoFPED and URA through several documents and websites ([www.ura.go.ug](http://www.ura.go.ug), [www.finance.go.ug](http://www.finance.go.ug), and [www.budget.go.ug](http://www.budget.go.ug)). However, most of the information is in English, yet most taxpayers cannot easily read and write English.

**Non declaration of Local Government Collections;** Local governments are mandated by the Local Governments Act to generate local revenues. These come in form of Local Service Tax, Hotel Tax and other local revenue source like market dues. However, there is hardly any information declared on actual collections in addition to inefficiencies in administration.

More still, there is still low participation in taxation issues by citizens. A study by SEATINI (2017/10), found that most taxpayers are not knowledgeable about the taxation regime and how taxes levied. Most taxpayers do not have an adequate understanding of the functions and mandates of institutions responsible for taxation in Uganda. There is confusion between the URA taxes and LGs taxes. Most taxpayers complain of double taxation where they pay taxes to URA and LG. This is partly because most citizens do not understand what kind of taxes they are supposed to pay and to which institutions. At LG levels, the non-payment of any direct taxes and overdependence on non-discretionary

central government transfers by LGs, makes it inherently difficult for citizens to engage in taxation issues, since the majority do not directly contribute to tax revenue<sup>3</sup>.

In terms of **Budget transparency**, despite declining scores since 2012, **Uganda is performing well compared to other EAC countries scoring 60 out of 100 in the Open Budget Survey in 2017**. This indicates that the government provides the public with significant information on the national Budget to enable the public to engage in budget discussions in an informed manner (IBP).<sup>11</sup> However, on public participation, Uganda scored 28 out of 100, indicating that government provides few opportunities for the public to influence the Budget processes.

## Recommendations

The study recommends the following:

### Government

- a. Parliament should amend Section 77(1)-(2) of the Public Finance Management Act (PFMA), 2015 which accords to the Minister of Finance, Planning and Economic Development the power to award tax exemptions, ensuring that the government must report and justify the award of incentives to parliament.
- b. Parliament should repeal Section 21 (q), (t), (s), (v) of Income Tax Law to provide tax holidays up to a maximum of five (5) years which can only be extended after an independent cost-benefit analysis.
- c. MoFPED should analyse the impact of any proposed tax reforms and base the decisions on the potential impact on reducing inequality before introducing any new measures.
- d. MoFPED should ensure full autonomy of URA and hold the Authority accountable to an agreed set of performance measures.
- e. The Ministry of Local Government and MoFPED should strengthen the capacity of LG tax administrations.
- f. MoFPED should publish on an annual basis a cost-benefit analysis of all tax expenditures and incentives with a view to reduce or remove those that are ineffective.

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<sup>3</sup> SEATINI & Oxfam. (2017). Taxation in Uganda: Review and Analysis of National and Local Government Performance, Opportunities and Challenges.

<sup>11</sup>IBP (2017), Open Budget Survey 2017. Accessed from : <https://www.internationalbudget.org/open-budget-survey/results-by-country/country-info/?country=ug>

- g. MoFPED should use oil and gas revenues to increase overall public spending on social sectors, especially education and health, by allocating more funds to meet the international and regional commitments
- h. URA should produce disaggregated data on taxpayers
- i. URA should increase the effectiveness of VAT and CIT collection which are currently underperforming through conducting effective tax gap analysis by working with a broad range of experts.

**Civil Society Organisations**

- j. CSOs should continue to build public awareness on taxation, the need to pay taxes and influence government affairs (including demanding quality public services).
- k. CSOs should simplify all tax laws and policies and translate them into local languages. At local levels, CSOs can work with citizens' groups and traders/ vendors' associations to provide simplified information about taxation.
- l. CSOs should carry out more advocacy on ensuring tax administration is transparent and accountable.
- m. CSOs should undertake more empirical studies to establish the impact of tax on various categories of people and
- n. CSOs should conduct gender audits of taxes and demand that government implements gender-sensitive tax policies.

<sup>1</sup>URA (2018), URA Statistics. Accessed from : <https://www.ura.go.ug/readMore.do?contentId=999000000001202&type=TIMELINE>

<sup>2</sup> SEATINI, TJNA & Oxfam (2016), Fair Tax Monitor: Uganda.

<sup>3</sup> Jellema J., Lustig N, Haas A, and Wolf S (2016), The impact of taxes, transfers, and subsidies on inequality and Poverty in Uganda. Accessed from: <https://www.cgdev.org/sites/default/files/taxes-transfers-subsidies-uganda.pdf>

<sup>4</sup> Makunike. C (2015), Towards Measuring Fairness of Tax Systems in Developing Countries. Tax Justice Network-Africa: Nairobi.

<sup>5</sup>URA (2018), URA Statistics. Accessed from : <https://www.ura.go.ug/readMore.do?contentId=999000000001202&type=TIMELINE>

<sup>6</sup> URA (2018), URA Statistics. Accessed from: <https://www.ura.go.ug/readMore.do?contentId=999000000001202&type=TIMELINE>

<sup>7</sup> SEATINI & Action Aid (2017), Corporate Tax Evasion and Avoidance in Uganda

<sup>8</sup> The TTR is comprised of Direct domestic taxes; Indirect domestic taxes; Government Taxes, Taxes on international trade; Fees and licenses; and Non-Tax Revenues (NTR)

<sup>9</sup> Republic of Uganda (2015), Second National Development Plan (NDPII) 2015/16 – 2019/20

<sup>10</sup>SEATINI and Oxfam (2017), Taxation in Uganda: Review and Analysis of National and Local Government Performance, Opportunities and Challenges. Accessed from: <http://www.seatiniuganda.org/publications/research/153-taxation-in-uganda-review-and-analysis-of-national-and-local-government-performance-opportunities-and-challenges-1/file.html>

<sup>11</sup>IBP (2017), Open Budget Survey 2017. Accessed from : <https://www.internationalbudget.org/open-budget-survey/results-by-country/country-info/?country=ug>